V.

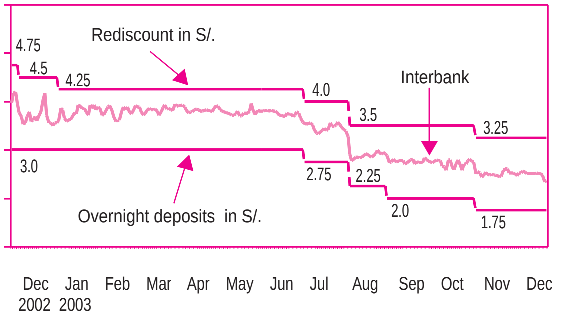
Money and credit

In 2003, inflation rate was 2.5%, just on the target set by the Central Bank. A looser monetary policy resulted in lower interest rates. Also, the dollarization of the financial system came down while the issue of securities in nominal soles increased.

Monetary policy

GRAPH 26

INTERBANK AND POLICY INTEREST RATES
(December 2002 - December 2003)



In 2003, monetary policy faced two different stages. Over the first semester the Central Bank maintained its monetary policy stance in a context of temporary acceleration of inflation, due to marked increases in international oil prices associated with the Iraq conflict. During this period, the average interbank interest rate was 3.8%

In the second half of the year, Central Bank's inflation forecasts for 2003-2004 were around the lower bound of the target range. As a result, monetary policy was loosened and policy interest rates were reduced. The interbank interest rate came down from 3.7% in June to 2.5% in December.

The Central Bank's policy interest rates set a corridor for the interbank interest rate. Through daily open market operations interbank interest rate is kept close to the center of this corridor, thus reducing interbank interest rate volatility. Larger stability of the interbank interest rate improves monetary policy communication making easier to the financial sector to extract the information contained in this rate and use it to set other interest rates of longer terms.

TABLE 15

LEVEL AND VARIABILITY OF THE INTERBANK INTEREST RATE
(Percentage points)

Year	Average	Standard deviation
1998	19.0	6.6
1999	14.9	4.8
2000	12.7	2.5
2001	8.6	0.9
2002	3.2	0.5
2003	3.4	0.1

MONETARY POLICY

In 2002, the Banco Central de Reserva del Perú adopted an inflation-targeting regime. The target rate was set at 2.5% (+/-1%) and is measured by the consumer price index, calculated by the INEI (National Statistics and Informatics Institute). The Central Bank also estimates the core inflation that tries to exclude price fluctuations associated with exogenous shocks and therefore concentrate on the assessment of medium-term inflationary tendencies.

Under the inflation targeting regime transparency has been improved. By means of recently adopted new strategies of communication with the public the Central Bank not only makes its target known, but also explains the measures to be adopted and the rationality behind them. Particularly, since 2002 the Central Bank publishes an Inflation Report, three times a year, describing the probable future evolution of the rate of inflation and its implications for monetary policy.

Furthermore, the Bank publishes its monetary policy decisions agreed in the first Board meeting of the month. The announcement includes any changes in the monetary policy stance reflected on the policy interest rates. This announcement forces the interbank interest rate into the corridor formed by the policy rates. Additionally, the announced daily open market operations are intended to place the interbank rate in the center of this corridor.

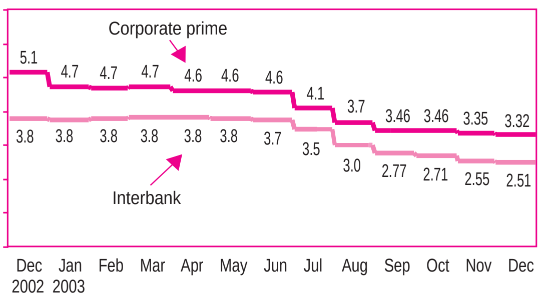
In order to achieve the desired interbank interest rate, an estimated of banking reserves held at the Central Bank as current account and daily open market operations are announced at 11:30 hrs. Interbank liquidity is expanded by repo operations with Central Bank Deposit Certificates (CDBCRP) and Treasury Bonds. Eventually, selling CDBCRP may contract liquidity.

Finally, there are windows of last resort using direct repos, rediscounts and foreign currency swaps. These are meant for banking institutions unable to cover their requirements through open market operations or in the interbank market. Overnight deposits might be accepted at these windows, so that banks may deposit their excess funds in the Central Bank. This sterilizes any excess liquidity in the interbank market.

In the Central Bank website (http://www.bcrp.gob.pe) the following data are daily published: initial liquidity and monetary operations announcement (11:30 hrs.), the result of these operations (12:30 hrs) and a summary of operations and bank liquidity at the end of the day. Further, the Central Bank lets operators know of its decisions through REUTERS, Bloomberg and DATATEC.

GRAPH 27

MONTHLY AVERAGE INTEREST RATE IN DOMESTIC CURRENCY
(December 2002 - December 2003)



Interest rates kept on falling

In 2003, the interbank interest rate came down from 3.8% at end 2002 to 2.5% at end 2003. This reduction has influenced short term interest rates and low-risk loan rates, i.e., the 90-day prime interest rate came down from 5.1% in December 2002 to 3.3% in December 2003.

TABLE 16

INTEREST RATES IN DOMESTIC CURRENCY
(Percent)

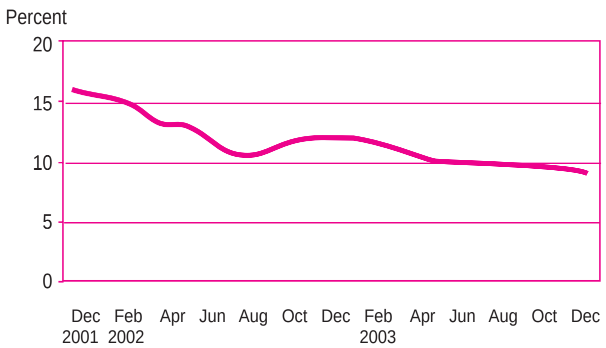
	2001				2002				2003			
	mar	jun	sep	dec	mar	jun	sep	dec	mar	jun	sep	dec
1. Interbank	10.3	16.0	5.9	3.1	2.5	2.6	5.4	3.8	3.8	3.7	2.8	2.5
2. Savings deposits	6.8	6.6	5.2	3.0	1.8	1.7	1.7	1.7	1.7	1.5	1.3	1.3
3. Prime lending	12.4	13.2	9.4	5.0	3.9	3.7	6.8	5.1	4.7	4.6	3.5	3.3
4. Average lending rate up to 360 days	21.3	21.2	19.4	17.2	15.5	14.1	14.0	14.8	14.3	14.0	14.3	14.0
5. CD												
Of the balance	12.6	12.4	10.8	7.5	5.4	4.8	4.1	4.7	4.7	4.8	4.3	3.9
Average term of the issues (in months) 1/	6	7	6	6	6	6	-	8	12	7	15	11

1/ Excludes one-week maturity issues of CD.

The decreasing trend of interest rates in 2003 was also seen in all lending operations of the banking system: commercial loan rates fell to 8.9%, small business credits to 52.2% and consumer loans credit to 40.9%.

GRAPH 28

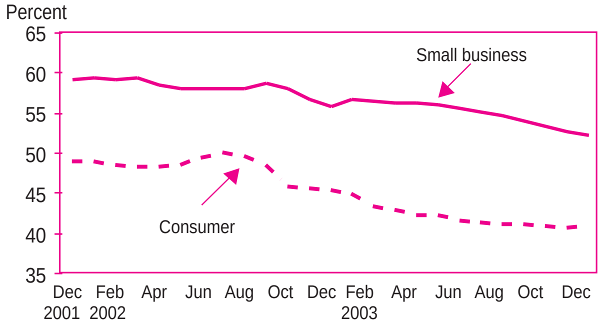
INTEREST RATE IN DOMESTIC CURRENCY FOR COMMERCIAL LOANS



Along with the reduction of monetary policy rates, returns on Central Bank Deposit Certificates (CDBCRP) for all terms fell over 2003, decreasing by 1.3 percentage points for certificates up to a year, similar to the interbank rate's reduction. However, for longer terms, the return went up, reflecting expectations of future rises of local interest rates, along with expectations about international interest rates.

GRAPH 29

INTEREST RATE IN DOMESTIC CURRENCY FOR SMALL BUSINESS AND CONSUMER LOANS



The stock of CDBCRP increased from S/. 1,635 million in December 2002 (24% of monetary base) to S/. 4,097 million at the end of 2003 (55% of monetary base). In this context, the maturity of the CDBCRP was extended to 3 years. Despite the increase in longer term CDBCRP, the average interest rate decreased from 4.7% to 3.9%, reflecting the fall in the interbank rate.

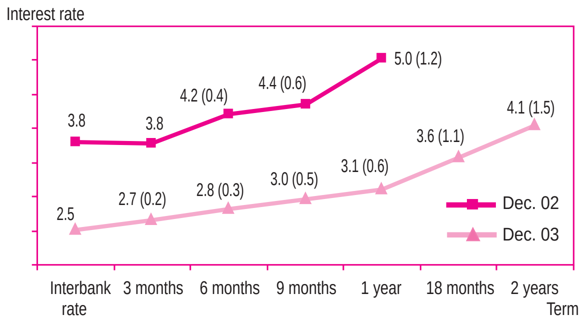
TABLE 17

CDBCRP BALANCE PER TERM
(Millions of nuevos soles)

	Dec. 2002	Dec. 2003
Up to 3 month	130	32
5 and 6 month	565	790
7 and 9 month	560	180
1 year and 18 month	380	2,280
2 and 3 year	0	815
Total	**1,635**	**4,097**
Average interest rate of the CDBCRP balance	4.7%	3.9%

GRAPH 30

CDBCRP YIELD CURVE[1/]



1/ Numbers between parenthesis indicate spreads respect to the interbank rate.

On the other hand, interest rates in dollars continued their downward trend, along with the three-month Libor rate, which fell from 1.4% in December 2002 to 1.2% in December 2003.

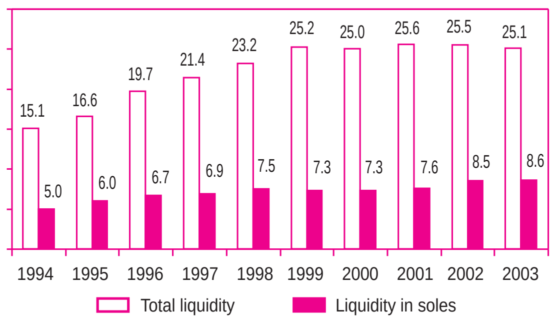
TABLE 18

INTEREST RATES IN FOREIGN CURRENCY
(Percent)

	2001				2002				2003			
	mar	jun	sep	dec	mar	jun	sep	dec	mar	jun	sep	dec
1. Interbank	8.6	5.0	4.1	2.1	2.1	2.2	1.9	2.2	2.4	1.5	1.1	1.1
2. Savings deposits	3.0	2.6	2.2	1.2	0.8	0.8	0.7	0.7	0.7	0.7	0.6	0.6
3. Prime lending	6.4	5.5	4.4	3.1	2.9	2.8	2.7	2.4	2.2	2.0	1.7	1.7
4. Average lending rate up to 360 days	12.3	11.6	11.1	8.7	8.7	8.3	8.1	8.1	8.8	7.9	6.9	7.2
5. Libor	5.0	3.8	3.0	1.9	2.0	1.9	1.8	1.4	1.3	1.1	1.1	1.2

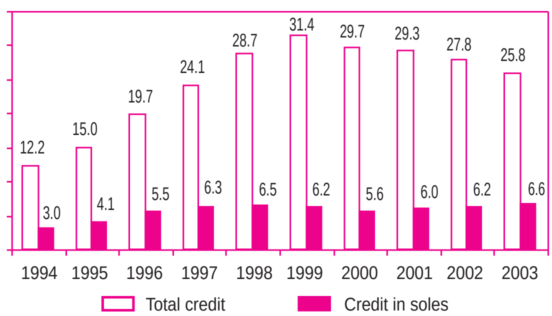
GRAPH 31

BANKING SYSTEM MONETIZATION COEFFICIENT
(In percent of GDP)



GRAPH 32

FINANCIAL SYSTEM CREDIT TO THE PRIVATE SECTOR
(In percent of GDP)



Broad money and credit in domestic currency increased

a. Broad money in nuevos soles increased by 11.8%

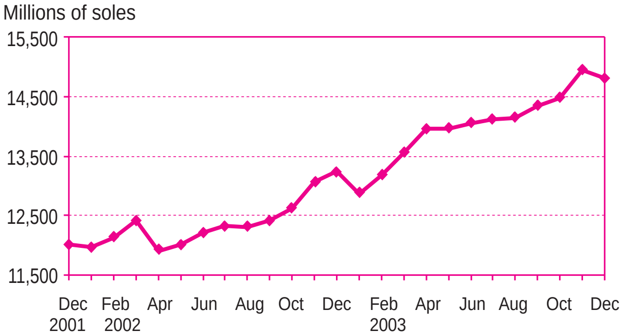
In 2003, banking system broad money grew by 1.0%, with rates of 11.8% for sol-denominated and -3% for dollar-denominated broad money. As a result, the dollarization coefficient fell from 65% to 62%. In terms of GDP, banking system average broad money diminished from 25.5% to 25.1%.

b. Sol-denominated loans granted by microfinance institutions and institutional investors went up

Financial system credit to the private sector grew by 11.7%, while dollar-denominated credit fell by 3.6%, decreasing the credit dollarization coefficient from 72% to 67%. The 24% increase in loans granted by microfinance

GRAPH 33

FINANCIAL SYSTEM CREDIT TO THE PRIVATE SECTOR IN DOMESTIC CURRENCY



entities and the 33% growth in institutional investors accounted for most of the expansion of credit in nuevos soles.

The fall of dollar-denominated credit was explained by decreases in banking institutions (-6%), and leasing institutions and others (-25%), which were not offset by increases in microfinance entities (26%) and institutional investors (36%).

TABLE 19

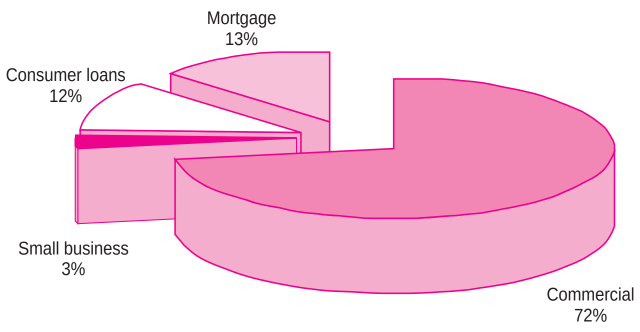
FINANCIAL SYSTEM CREDIT TO THE PRIVATE SECTOR

	In domestic currency			In foreign currency		
	Balances in millions of nuevos soles		Percent change	Balances in millions US dollars		Percent change
	Dec.02	Dec.03	Dec.03/ Dec.02	Dec.02	Dec.03	Dec.03/ Dec.02
Commercial banks 1/	7,660	7,782	1.6	10,015	9,429	-5.9
Banco de la Nación	434	512	17.9	36	22	-38.0
Microfinance institutions	3,107	3,866	24.4	367	461	25.8
Banks (MiBanco and Banco del Trabajo)	774	970	25.3	34	49	44.1
Local government S&Ls	848	1,057	24.6	111	178	60.2
Rural S&Ls	135	177	31.0	44	47	8.0
Saving and credit cooperatives	381	444	16.8	101	112	11.4
Edpymes	130	177	35.8	31	40	27.6
Financial companies	840	1,042	24.1	45	34	-24.2
Institutional investors 2/	1,653	2,191	32.6	800	1,090	36.2
AFPs	1,102	1,449	31.5	445	517	16.2
Insurances companies	493	579	17.4	37	59	58.7
Mutual funds	58	163	182.5	318	514	61.4
Leasing companies and others	**393**	**450**	**14.3**	**858**	**640**	**-25.4**
Total financial system	**13,247**	**14,801**	**11.7**	**12,077**	**11,643**	**-3.6**

1/ Excludes Banco del Trabajo and MiBanco.
2/ Mainly securities issued by the private sector.

GRAPH 34

CREDIT COMPOSITION OF THE COMMERCIAL BANKS



As of December 2003, banking system credit composition was: commercial credits 72%, mortgage 13%, consumer loans 12% and small business 3%.

c. Non-performing loans down to 5.8%

Bank portfolio improved during 2003 as shown by the main financial indicators, continuing the trend observed since 2001. In particular, the return on equity ratio improved from 8.4% to 10.9% between December 2002 and 2003, whereas the ratio of non-performing loans to gross loans fell to 5.8%, its lowest level in 6 years.

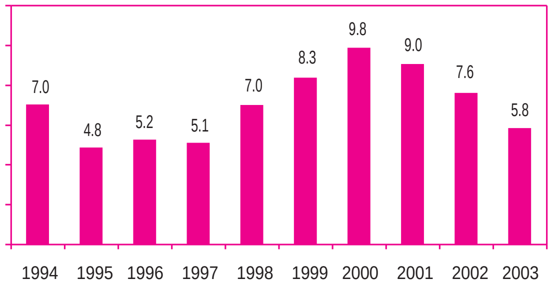
TABLE 20

FINANCIAL INDICATORS OF BANKING INSTITUTIONS
(In percent)

	2001	2002	2003
Non-performing loans / gross loans	9.0	7.6	5.8
Provisions / non-performing loans	118.9	133.2	141.0
Return on equity	4.5	8.4	10.9

GRAPH 35

NON-PERFORMING LOANS OF COMMERCIAL BANKS [1/]
(Percent)



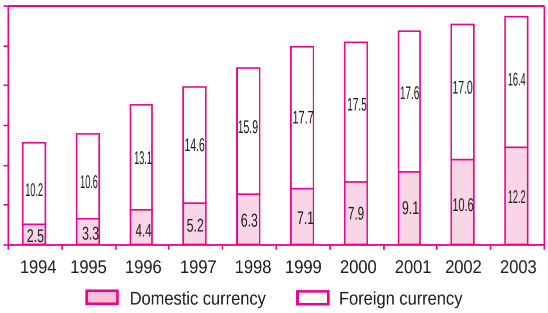
1/ Non-performing loans to total loans.

Financial savings and capital market kept on growing

In 2003, financial savings, which include the financial system liabilities with the private sector but excludes money holdings, increased from 27.6% to 28.5% of GDP.

GRAPH 36

FINANCIAL SAVINGS
(In percent of GDP)



Continuing the trend of recent years, this growth was led by the sol-denominated savings, with a 24.5% increase, whereas the dollar-denominated fell by 2.3%. As percent of GDP, financial savings in soles went from 10.6% to 12.2%, explained by the 34.8 % real increase of private pension funds, reaching 10.4% of GDP. At the end of the year, these funds represented 34% of total financial savings and 74% of the sol-denominated.

On the other hand, real financial savings in dollars dropped by 2.3% due to reductions in Banks' liabilities (6.3%) only partially offset by the growth of mutual funds (18.7%).

The average outstanding amount **of bonds** was S/. 12,892 million in 2003, the equivalent of 5.4% of GDP, the highest ever recorded. In real terms, the average stock of bonds grew by 19%, mostly explained by corporate and Treasury bonds.

In March 2003, the Government resumed the issue of sovereign bonds being followed by private sector issues. In July the Government issued its first 5-year bond in nuevos soles, placed at a rate of 9.7%. At the end of the year, the rate was 6.6%.

During the year, the stock market as measured by the **Lima Stock Exchange** stood out in the region, after Argentina and Brazil, with its average and blue chip indices growing by 75% and 81%, respectively. Strong international metal prices, in particular those of gold, copper and zinc as well as strong foreign stock exchanges pushed stock prices up. The cumulative annual yield of mining shares was 178%.

The **private pension fund** stood at S/. 21,844 million (US$ 6,308 million) by year-end, a nominal increase of 38.7%. The fund is now equivalent to 10.3% of GDP compared to 7.9% of GDP in 2002. As of December, the fund had 3.2 million members, (28.2% of the labor force), an increase of 6.7%.

TABLE 21

FINANCIAL SAVINGS BY TYPE OF INSTITUTION

	Millions of nuevos soles as of December 2003			Percet change	
	2001	2002	2003	2002	2003
I. DOMESTIC CURRENCY	**20,005**	**23,694**	**29,495**	**18.4**	**24.5**
1. Banking system	5,563	5,932	5,721	6.6	-3.6
2. Non-banking system	14,441	17,762	23,774	23.0	33.8
Local government S&Ls	320	415	628	29.9	51.2
Rural S&Ls	73	101	142	39.0	40.7
Saving and credit cooperatives	315	378	423	20.0	11.8
Leasing companies	0	6	14	n.a.	139.9
Financial companies	145	93	28	-35.9	-70.3
Private system funds	12,894	16,202	21,844	25.7	34.8
Mutual funds	509	365	485	-28.3	32.8
Insurance companies	181	199	209	9.9	5.0
Others	3	2	3	-33.3	50.0
II. FOREIGN CURRENCY 1/	**33,939**	**35,168**	**34,344**	**3.6**	**-2.3**
1. Banking system	29,209	28,998	27,157	-0.7	-6.3
2. Non-banking system	4,730	6,170	7,187	30.4	16.5
Local government S&Ls	435	595	691	36.8	16.1
Rural S&Ls	91	127	143	40.4	12.2
Saving and credit cooperatives	453	483	507	6.6	5.0
Leasing companies	89	222	273	150.6	22.6
Financial companies	4	3	3	-13.4	-3.3
Mutual funds	3,334	4,379	5,197	31.4	18.7
Insurance companies	325	357	374	9.9	4.5
III. TOTAL	**53,944**	**58,862**	**63,840**	**9.1**	**8.5**

1/ Valuated to the end of period average ask/bid exchange rate.

The value of **mutual funds** was S/. 5,682 million (US$ 1,642 million), a 23.2% increase over 2002. Mutual funds dealing in U.S. dollar fixed-income instruments accounted for 87.6%, yielding 1% on the average. Fixed-income funds in soles yield averaged 3.9%.